Britain’s Annuity Muddle

By Editor Test *Wed, Sep 1, 2010*

Surprisingly few retirees use the ‘open market option,’ which allows them to transfer their money at retirement from the asset management company where they accumulated their savings to another provider with a higher annuity rate.

In the United Kingdom, an estimated six out of ten people are settling for retirement income that is up to 30% lower than possible because they don’t shop around for the best annuity rate when they retire and convert their savings to income. The situation sheds light on the decisions U.S. consumers might face if 401(k) companies were to offer competing income options.

The financial secretary to the British Treasury, Mark Hoban, is reported to have asked the Association of British Insurers (ABI) to explain why so few people use the ‘open market option,’ which allows new retirees to transfer their money from the asset management company where they accumulated their savings to another provider with a higher annuity rate.

In the first half of this year, only around 40% of retirees took advantage of the open market option. The rest settled for the annuities offered by the companies with which they had built up their “pension pots,” potentially missing out on hundreds of pounds of extra pension.

Douglas Baillie, a Perth-based adviser who this year launched the online service comparemyannuity.co.uk, believes there are several reasons why more people do not shop around for a better annuity. “There is a lack of awareness generally about the open market option and pension companies are not as forthright about it as they should be. Although they are obliged to mention it to policyholders as they approach retirement, they tend to bury it in the small print at the end of a six-page letter.

“Also when companies spell out the choices under their policy, they only write down the pension which they offer, or the alternative of a tax-free cash lump sum plus a reduced pension. What they really should be doing is including a third choice telling policyholders they can buy a possibly better pension elsewhere and how they can go about it.”

Another specialist comparison service was launched this week by fairinvestment.co.uk.

Questioned by The Herald, the ABI refused to comment beyond saying: “The ABI and its members are committed to making the process of shopping round for an annuity as straightforward as possible.”

However, David Trenner of Intelligent Pensions in Glasgow is skeptical. He says: “Why is it that the ABI even allows companies which don’t want to sell competitive annuities to continue doing so, even though they are clearly in breach of their duty to treat customers fairly? The answer is that the ABI is a trade body so it can hardly turn round to the likes of companies such as Scottish Widows or Friends Provident and tell them what to do.”

“Take the example of a 65-year-old woman who may have saved for 30 years with the Scottish Widows and built up a pension fund of £60,000,” Trenner said. “If she was retiring today she could be offered an annuity of £3300 per annum, when she could get £3748 just by switching to Aviva. Why would she want to take a lower pension for the rest of her life just because she has saved with a particular company?

People with health problems or lifestyle issues, such as smoking, may be able to get even better annuity rates, but not all pension companies offer specially enhanced annuities so their customers may be even more disadvantaged. Baillie recently managed to improve the pension of one of his customers, who was in poor health, by a massive 60%, though the normal uplift is more in the region of 20%.

Advisers receive a 1% commission when they arrange an annuity on your behalf, or they may ask for a fee. If you have only a small pension pot, it may be uneconomic for an adviser to put in the work required and the fee may be disproportionate. However, you can do some shopping around for free by visiting the Financial Services Authority’s annuity comparison tables at www.moneymadeclear.org.uk.